



2015 Economic Expectations Survey

Trend lines for the coming year

Virginia CPAs are more optimistic about the commonwealth than the country



The survey says ...

CPAs see health-care costs as the biggest financial issue facing Virginia companies

by Veronica Garabelli



John Braun's health insurance costs rose 22 percent this year. It could have been worse.

You'd think federal budget cuts would be the biggest worry for a government contractor like Arlington-based Dynamis. Nonetheless, a more pressing issue for John Braun, its president and chairman, is the rising cost of health care.

Dynamis' health insurance costs increased 22 percent from 2013 to 2014. That's actually the good news — the original quote was much higher. "We actually ended up negotiating with [the insurance company] and getting that number down," Braun says.

Health-care expenses are the No. 1 financial issue Virginia businesses are facing, according to the 2015 Economic

Expectations Survey conducted by the Virginia Society of Certified Public Accountants. The society surveyed 9,598 members on their outlook about the economy and financial hurdles their clients are encountering.

One of those hurdles, they say, is federal health-care reform. Seventy-four percent of the more than 300 respondents believe the Affordable Care Act is hurting the U.S. economy. But when asked whether the ACA should be reformed or repealed, CPAs were almost evenly split — 51.8 percent want it reformed, while 48.2 percent say the law needs to be repealed.

Overall, CPAs had a cautious outlook about the economy in the Old Dominion and the U.S. but were more optimistic than previous surveys.

A sustained recovery?

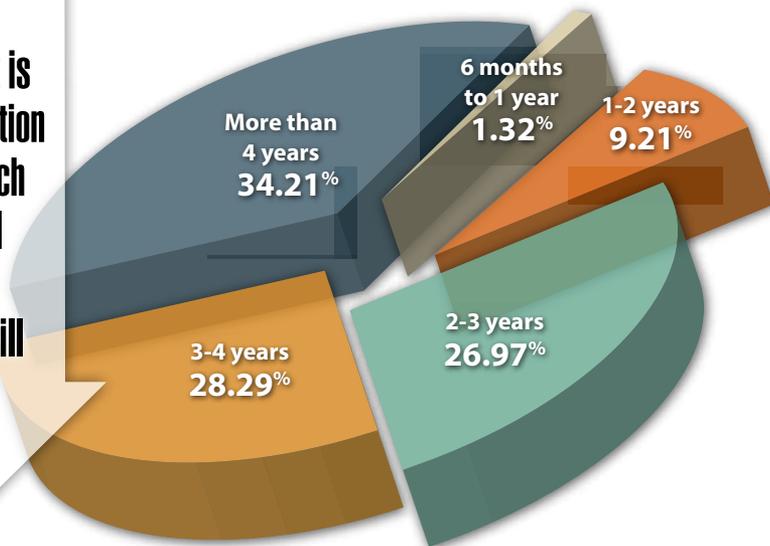
In the latest survey, CPAs are almost evenly divided in deciding whether the U.S. is in a sustained economic recovery. More than 30 percent believe that a full recovery will take more than four years.

That somewhat gloomy response, however, still represents a sunnier outlook than seen in the VSCPA's survey three years ago. Back then, more than two-thirds (67.7 percent) of respondents did not believe the U.S. had begun a sustainable economic recovery while 32.3 percent believed it had.

Although most CPAs taking the most recent survey are "somewhat" or "very" pessimistic (42.7 percent) about the national economy next year, they have a brighter outlook about Virginia's economy for 2015. More than 38 percent are "somewhat" or "very" optimistic about the commonwealth's economy as a whole as opposed to 28.6 percent who have "somewhat" or "very" pessimistic views. The remaining 31 percent hold a "neutral" or "balanced" opinion.

Respondents also find a lot to like in Virginia's business climate, with 68.7 percent rating it "good." A significant percentage (almost 49 percent) think capital investments in the state will stay the same in 2015 while 39 percent think investments will increase. Only 12 percent think capital investments will decrease.

Q2: What is your prediction for how much longer a full economic recovery will take?



Rough roads

In addition to health-care costs, the survey says infrastructure is the state's most pressing issue. (Other top issues are federal budget cuts, government regulation and education.)



Ryan Losi, executive vice president of PIASCIK, a CPA firm in Glen Allen, says the state's biggest infrastructure problem is the deteriorating condition of its roads. "Our roads were not built to handle the container volume that they're currently handling ... and cars don't really beat up interstates and highways; trucks do," Losi says.

Some relief for the commonwealth's roads

was expected to come from a landmark transportation-funding bill approved by the Virginia General Assembly in 2013. When it was passed, the legislation was supposed to boost transportation projects by \$4 billion, although that number depends on economic conditions.

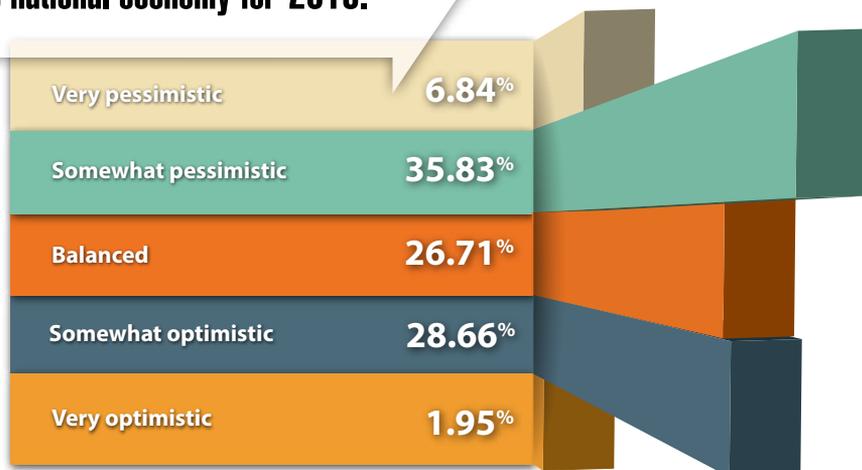
A proposed federal law, the Marketplace Fairness Act, was expected to supply part of the transportation funding. It would allow states to collect sales tax from out-of-state Internet retailers. The bill, however, is stalled in Congress. If the legislation isn't passed by Jan. 1, the commonwealth's wholesale gas tax will increase from 3.5 to 5.1 percent.

Rough roads are bad for business, but the survey identifies the availability of an educated workforce as one of two factors that have the greatest impact in retaining or attracting business to Virginia (the top factor being a pro-business climate).

Stephen Fuller, director of the Center for Regional Analysis at George Mason University, says Virginia will need to fill almost 1.3 million new and replacement jobs between 2012 and 2022. That job-creation number is lower than previous projections because of the slowdown of the Virginia economy as a result of decreased federal spending from 2011 to 2014, he says.

Another economist, Chris Chmura, the head of Chmura Economics & Analytics in Richmond, sees education as the biggest long-term issue for the state in creating a skilled workforce. She believes Virginia needs to ensure students receive the skills for occupations that are in demand and that they are trained in a cost-effective manner. "It seems that our education system is in need of undergoing some change to help bring down the costs for students," she says.

Q3: Describe your economic outlook on the national economy for 2015.



Federal spending

While education is a long-term issue for



Chmura, she says federal budget cuts will be the biggest issue confronting Virginia next year.

The CPAs also identify the federal spigot as a major dilemma. Almost 86 percent of respondents said the commonwealth has not done enough to lessen its dependence on federal spending.

Respondents also say partisanship — largely blamed for triggering sequestration (across-the-board spending cuts) — is preventing the federal government from addressing urgent needs that have an impact on business. Federal budget cuts also were especially a big concern for CPAs in Northern, Southeast and Central Virginia taking the survey (they picked “infrastructure” or “health-care costs” as the most pressing issue for the state, but “federal budget cuts” were the No. 2 concern).



Chmura

Although Northern Virginia rebounded quickly after the recession and regained the jobs it lost, “right now they’re dead in the water,” Chmura says. “Employment is not growing, and that’s what’s driving Virginia’s economy to be so weak.” In September (the last available statistic), employment in Virginia had grown by three-tenths of a percentage point since September 2013. The national job-growth rate, however, increased by 1.9 percent during the same time period.

BirchGrove Consulting, a Potomac, Md.-market research firm, predicts the commonwealth stands to lose approximately \$13.5 billion of its defense funding from fiscal year 2013 to FY2018. Northern Virginia and Hampton Roads will be the hardest hit by sequestration. They stand to lose 35 percent and 23 percent of their defense funds, respectively.

Virginia has not been guaranteed a certain amount of defense dollars, but “it is fair to say, all-things-equal, the commonwealth is facing reductions of that magnitude in the future years,” explains Raymond C. Bjorklund, president of BirchGrove Consulting, in an email.

Yet sequestration hasn’t hampered growth at Dynamis, which primarily provides services to the U.S. departments of Defense and Homeland Security. The firm employs about 85 people and was recently named to Inc. magazine’s list of the 5,000

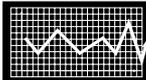


The employer mandate of the Affordable Care Act goes into effect in 2015.

What effect do you expect that the mandate will have on businesses?	Major effect	Minor effect	No effect
	54.75%	42.30%	2.95%

Is the Affordable Care Act helping or hurting the U.S. economy?	Helping	Hurting
	25.93%	74.07%

If the Affordable Care Act is hurting the U.S. economy, should it be repealed or reformed?	Repealed	Reformed
	48.21%	51.79%



Describe your outlook on the economy in Virginia for 2015 in the following areas.

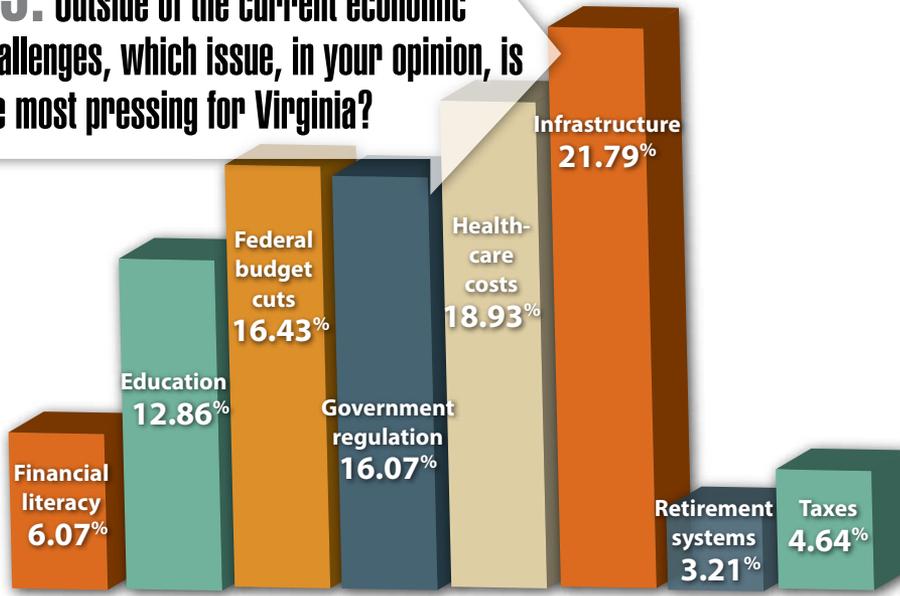
	Very pessimistic	Somewhat pessimistic	Balanced	Somewhat optimistic	Very optimistic	Not applicable
Your company, firm or organization	3.39%	16.61%	24.75%	31.53%	18.31%	5.42%
The industry you represent, if you work in industry	3.83%	14.63%	20.56%	24.74%	11.15%	25.09%
Overall	5.44%	23.13%	30.95%	32.99%	5.78%	1.70%



Impact of partisanship on business

Is partisanship at the federal and state level preventing government from addressing urgent needs that have an impact on business?	Yes	No	Don’t know
	85.10%	8.94%	5.96%

Q9: Outside of the current economic challenges, which issue, in your opinion, is the most pressing for Virginia?



fastest-growing companies. Many other government contractors, however, have not been as fortunate, Braun says.

“Companies that are either small or are willing to bid on jobs that they can do for a low price tend to beat the larger and the midsize companies because they are more flexible ... they are cheaper and they are in an environment where contracting officers are choosing the low price over the known provider,” he says. “So for us, actually, this strange ... convolution of events has been fairly good. If you’re a midsize company not protected by small-business status and not really in a position to offer a low bid, it’s been very dramatically painful.”

The employer mandate

Dynamis may be able to offer lower bids than its counterparts on contracts, but offering fewer benefits to its employees is not an option. Because he already offers health coverage, Braun doesn’t expect to be affected by the ACA’s employer mandate going into effect next year.

Survey respondents, however, believe the mandate will have a major effect on businesses next year. It will force some companies to offer health-care benefits to their employees for the first time.

The mandate says that, in 2015, employers with 100 or more full-time-

equivalent employees will have to offer workers affordable health-care coverage that complies with ACA standards. If they don’t, and that employee receives a tax credit for purchasing insurance on the Health Insurance Marketplace (healthcare.gov), the employer may have to pay a penalty. In 2016 and beyond, the mandate will affect businesses with 50 or more full-time-equivalent workers (in this case, a full-time employee clocks in an average 30 hours or more per week).

The survey also identifies health-care costs as the top issue that needs to be addressed in the 2015 Virginia General Assembly session.

Nonetheless, there may be little that the Virginia General Assembly can do. “We will ultimately be examining potential reforms to the industry, but the provisions of the law may stymie that effort,” Del. Kathy Byron (R-Lynchburg), chair of the legislature’s Health Insurance Reform Commission, says in an email. “Because the ACA is imposed on the states and uses a ‘one-size-fits-all’ approach to health care, the options available to states that would mitigate its negative effects are limited.”

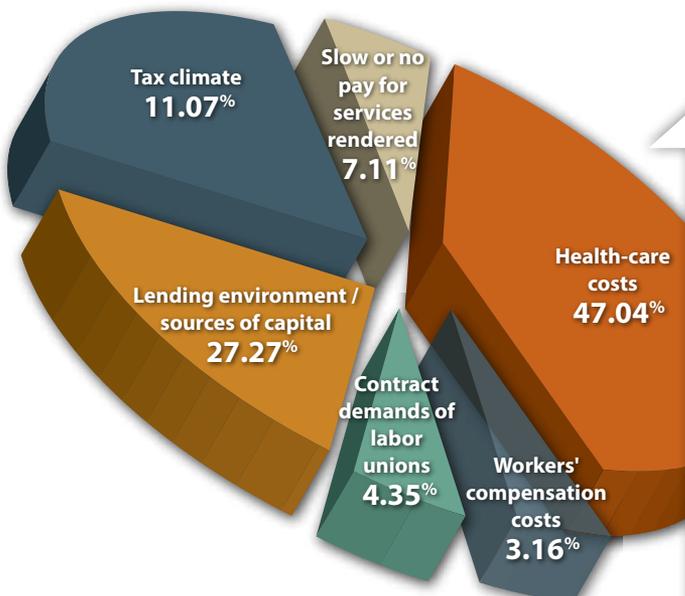


DuVal

Barry DuVal, president and CEO of the Virginia Chamber of Commerce, believes the continued roll-out of the ACA will especially affect small businesses (defined by the chamber as companies with 250 full-time workers or fewer), because most large employers are already meeting ACA’s standards. Overall, the chamber estimates that businesses in Virginia will incur \$16.4 billion in ACA-related taxes from 2014 through 2022.

Greg Lawson, partner at Dixon Hughes Goodman in Newport News, assesses the confusion businesses are facing: “The issues are from a business perspective, in my mind: Are we covered under this legislation or not? Are there strategies where we can avoid coverage under this legislation? How do we educate our employees as to what opportunities the legislation presents for them? How do we manage our entire employee benefit model around this regulation and still be able to pay a competitive wage to our employees and give fair return to our shareholders?”

Fielding those kinds of questions, no wonder CPAs are concerned about the effects of the ACA. **VB**

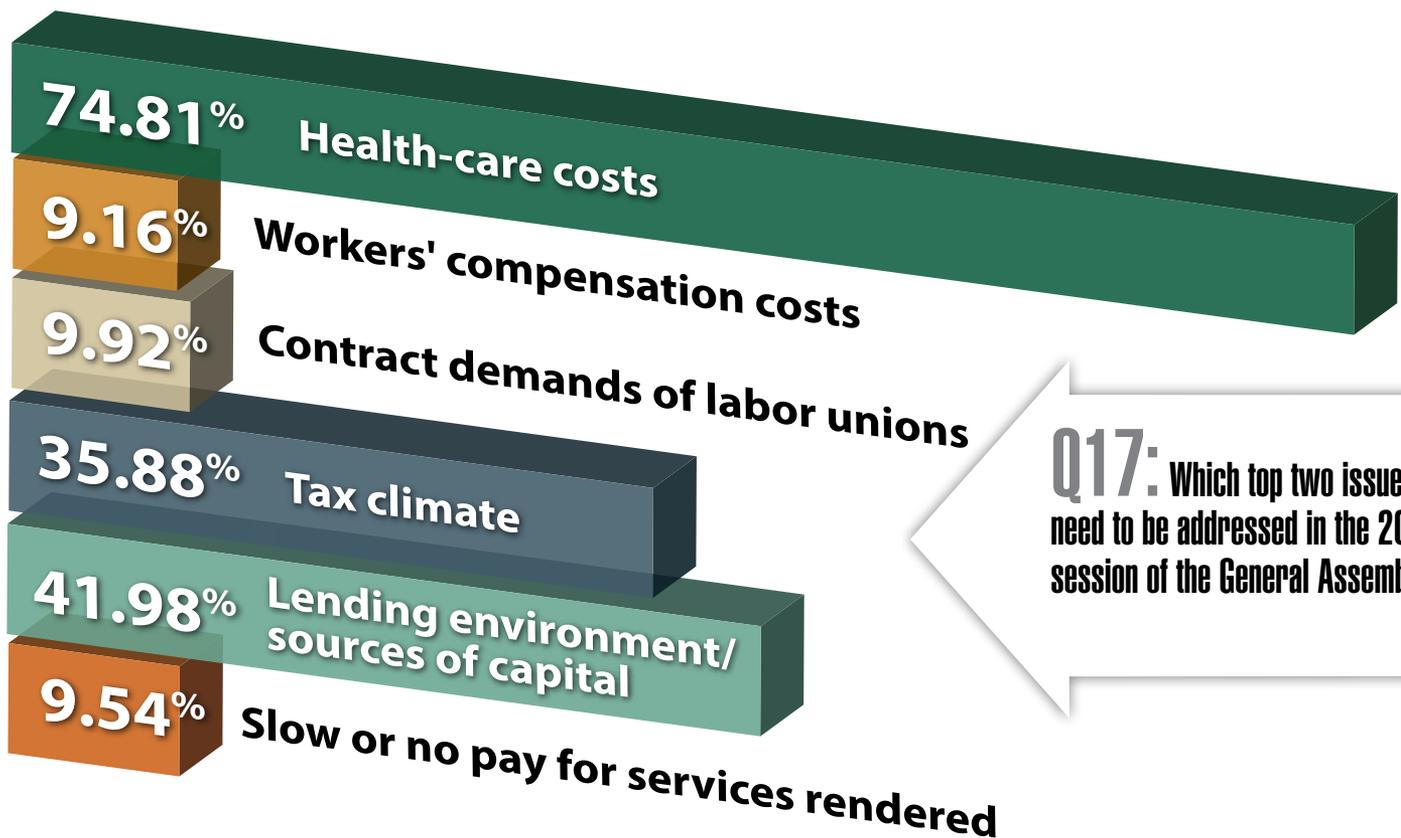


Q16: What would you cite as the top financial problem experienced by Virginia businesses?



Business climate in Virginia

How would you rate the overall business climate in Virginia as compared to that of neighboring states?	Excellent	Good	Fair	Poor
	12.93%	68.71%	17.35%	1.02%
In 2015, do you think capital investments in Virginia will increase, decrease or stay the same?	Increase	Decrease	Stay the same	
	39.04%	11.99%	48.97%	
Is Virginia doing enough to attract investment from foreign companies?	Yes	No	Don't know	
	23.21%	26.96%	49.83%	
The Virginia corporate tax rate is 6 percent. Should Virginia consider lowering the rate?	Yes	No	Don't know	
	35.84%	54.61%	9.56%	
Do you believe Virginia small businesses currently have access to adequate credit to sustain and grow their businesses?	Yes	No	Don't know	
	37.15%	40.28%	22.57%	



Q17: Which top two issues need to be addressed in the 2015 session of the General Assembly?

Virginia Business Publisher Bernie Niemeier introduces the roundtable panel (at right, left to right): Charles Equi, Greg Lawson, Ryan Losi and Colette Wilson. At left are magazine Editor Robert Powell and Special Projects Assistant Editor Veronica Garabelli.



*To better understand the top issues highlighted in the survey, Virginia Business and the Virginia Society of Certified Public Accountants held a roundtable discussion in September at VSCPA's Richmond headquarters. The panelists were **Charles Equi**, owner and managing partner of Equi & Co. in Roanoke; **Greg Lawson**, partner at Dixon Hughes Goodman in Newport News; **Ryan L. Losi**, executive vice president of PIASCIK in Glen Allen; and **Colette Wilson**, chair of the VSCPA board of directors and former partner at Cotton & Co. in Alexandria. An edited transcript of the discussion follows.*

Looking behind the numbers

CPAs discuss how economic issues are affecting Virginia businesses



Virginia Business: Looking at the results for the past two years, why does the survey continue to show that many CPAs believe a full recovery is still several years away?

Equi: Within my practice, I've had a handful of clients who have had the best years they've ever had the last three years,

just astounding years. But the majority of them are just barely getting over the hump. They're just moving along. I think a lot of the practices from my sector are seeing that ... We haven't had that breakthrough, that innovation that's going to move the whole country forward. And usually when we came out of these economic downturns, we saw

something that moved us forward ...

VB: Is sequestration taking a toll on companies in the state?

Wilson: Absolutely, I think it has. In terms of this question [which was, "Has the region done enough to lessen its dependence on federal spending?"] I



Colette Wilson thinks repealing the Affordable Care Act would make things worse.

think for the respondents to say Virginia hasn't lessened its dependence on federal spending — it's kind of hard to lessen your dependence on that spending when the spending doesn't stop. The federal government continuously ... spends. And with our proximity to the nation's capital, I just think it's obvious, and it's hard to lessen that dependence.

VB: Should the Affordable Care Act be reformed or repealed?

Losi: Well, if I were running for office, I'd be really stuck. It's 50/50 across the commonwealth. Certain areas it's a little bit more skewed ... I am a business owner, small-business owner, so I understand the burdens that businesses have, a lot of compliances.

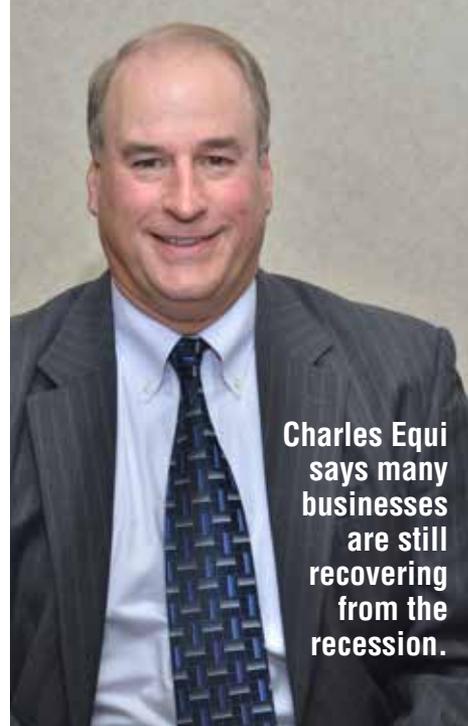
Red tape is what you'll hear. A lot of paperwork and red tape and things that require administrative resources are put upon us because of regulation. And so, for instance, why are we withholding-tax agents that are unpaid when it's really not our responsibility? Well, these are things that add on to it. So, the business community gets, a lot of times, forced to be the responsible agent for these plans, whether we like it or not. From a business standpoint, I don't like to see more administrative burden. It distracts us from our core businesses.

But when you look at it from a global standpoint, we have an aging population. We're one of the few developed countries that doesn't have a national policy regarding health care. I can see that argument right there.

Personally, my opinion is that ... a business shouldn't be responsible for the health care of its employees. It should be responsible for ... paying them a fair compensation, and then they can choose.

Equi: [The ACA] is very cumbersome for us — any law that's passed, any tax law the business community has to deal with. But what readily happens is that the CPAs at the end have to deal with it. We're the one who has to finalize it on the tax return, collect the money and submit it back. So it always comes back on us no matter what ball it is. Health care, you name what entry, it's going to come back on us. We pretty much have to enforce the law. So there's a theory, go ahead and just implement it because it's just causing so many problems right now for us ... and it's a moving target. Every time I think we've got it, they change it or delay it.

I don't know if there is a right answer for that, but it is going to be very costly. Whether my personal opinion matters or not, whether you want it or not, I think it's coming. And whether different parts



Charles Equi says many businesses are still recovering from the recession.

of it will be changed, I think it will be. But from a CPA standpoint, just trying to handle these, it needs to be moved on, implemented so we can tell clients what to do instead of trying to guess all the time.

Wilson: The answer to the question for me is reform. I think, like Ryan said, it has gone so far: It's coming, it's here, reform is needed. I think to ... repeal it would ... make things completely worse. But it does put the onus on the CPAs,



Greg Lawson believes transportation improvements could influence the outcome of the next round of military base closings.



Ryan Losi thinks the Obama administration needs a deal maker who can work with Congress.

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and that is something they should be looking to us for. We have to deal with the businesses, or we have to deal with the individuals, and we're the ones who are going to put forward what we feel needs to be right, what we feel needs to be consistent in how to handle these issues. But, I think, repealing it would just cause more harm than it already has done thus far.

VB: [Virginia has dropped in CNBC's "Top States for Business" from No. 3 in 2012, to No.5 in 2013 and to No. 8 this year. What, in your opinion, is the reason for this continued drop?]

Equi: Taken from a sports [comparison,] if I go from No. 3 to No. 8, I'm still happy, but ... over the past years, we've had issues within the political realm — trying to solve the budgets, trying to meet the funding and things of that nature. I think that has had a big part to play in it.

Lawson: Some of the other states in our surrounding markets have discovered the advantage of being aggressive in attracting business locations. South Carolina has been very aggressive in that area with large incentives and has been successful in getting some major manufacturing facilities to locate there that were also looking at Virginia as a possibility. So, I think that's one thing — just the field of competition has expanded.

I think secondly, a broader comment, Virginia once was known [for its] genteel, collegial legislature that could get things done, and we enjoyed that benefit for decades. The last decade or two, it has become much more partisan. And I think that has adversely impacted on how businesses in surrounding states see us from a competitive standpoint ...

VB: Infrastructure was identified as the most pressing issue facing Virginia. ... What do you think are the critical infrastructure issues we have?

Losi: My take is ... that it's our roads. Everyone has experienced or read the news headlines where we're experiencing record exports ... Our roads were

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not built to handle the container volume that they're currently handling ... And cars don't really beat up interstates and highways; trucks do. And so that has been a big challenge. ...

Lawson: Yes, I think Ryan is right on point on that. And me, being from the Southeast, [it's also] transportation ... The I-64 corridor from Hampton up through Richmond is critical, as well as solving the tunnel issues getting from Hampton into Norfolk and Virginia Beach. Those are critical factors. And they're not only critical for our commercial enterprises and our ports ... They're also critical to the military.

Sequestration is the law of the land right now. We're going to have another [round of] BRAC [the Base Realignment and Closure process]. It will probably be in 2017. And I can tell you there are a concentration of military bases in the Southeast. They're looking very closely at that issue. And if we can make some progress in solving the 64 corridor between Hampton and Richmond, get some shovels in the ground on that project, having a plan as it relates to the Hampton Roads Bridge Tunnel, then that is going to be critical in any considerations from the BRAC perspective. ...

[Naval Station Norfolk] has the capacity and the technology, including nuclear engineers to house the entire Atlantic Fleet. Naval Weapons Station Yorktown has the infrastructure capacity to merge with other two naval weapons stations. Those issues would be tremendous ... save billions of dollars in the national defense budget. SEALs, special [operations], are an increasingly important element in our national defense in addressing critical problems. We have the facilities and the commands in place to consolidate those activities.

VB: Our tax climate was identified as one of the top issues that needs to be addressed at next year's General Assembly session ... What are the specific tax issues that businesses are going to face next year?

Lawson: From a state legislature level, Virginia still enjoys a relatively low

strategic

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individual tax rate and a relatively low corporate tax rate. ... Those tax rates have remained unchanged, I think, probably for a couple of decades. So, I think that's positive. That brings some certainty. It's still a very friendly state from a tax perspective for businesses to operate in and relocate to.

There are some issues around the margins as it relates to the level of funding we're going to get for business incentives, tax credit programs and some of those things that have to be reauthorized every year, so we watch those very closely.

Losi: I would just add in that certainly the VSCPA has done a great job of helping tax policies stay simple compared with other states. We try to conform as much as possible to make it simple from an individual's compliance standpoint as well as a corporate compliance standpoint. And also having, for the most part, a fixed rate. There is a little bit of graduation on the individual side, graduated rates, but pretty much a fixed rate so you can plan ... I think those are things that boded well for Virginia. I think the VSCPA has been very active

with the General Assembly sessions explaining, reinforcing and ensuring that stays pretty much solid.

Wilson: Like Ryan said, when we go to the General Assembly, it almost seems like no matter what the issue is related to taxes, we're always talking about conformity because this is the burden on the taxpayer, the burden on the businesses, and just understanding what Virginia needs to do as compared to the federal government. Passing [a bill] late and not having it conforming on so many different issues is just a burden in itself no matter what the specific issue is ...

VB: Access to credit continues to be a problem, the survey shows. Are loan requirements too strict?

Equi: I've seen some relaxation there. If you move it from a business standpoint to an individual standpoint, it's still pretty difficult to get a home mortgage loan. Difficult is not the word. It's a challenge to go through the process is what I want to say. ... From a business standpoint ... I have seen a little bit of loosening up. A line of credit is a little bit easier to get. The real estate is still a little bit dicey when you're going in. It depends on where the property is, what kind of property it is, whether they're going to give it to you. But it depends on the bank, and again, it depends on what area you're talking about.

Losi: When a majority of loans are being dictated by [the Federal Housing Administration], that's what's going to cause it. When private lenders will not come in the game yet to lend, you're going to have these struggles because you have one agency dictating loan terms. So, everyone has to conform to these really high documentation levels. And they don't want to be sued like the court case that just got announced ... for misrepresenting the loan portfolio that they're packaging and selling [In September, Virginia filed a lawsuit seeking \$1.15 billion in damages against 13 banks accused of misleading the Virginia Retirement System. The suit alleges the banks misrepresented the residential mortgage-backed securities it sold to VRS, which was forced to

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sell most of those securities at a loss of \$383 million.]

VB: [What top issues need to be addressed in U.S. Congress?]

Losi: My thoughts are, we need a deal maker in the administration who will go to Congress and compromise ... make a deal, and cut deals that help the entire country. We've had 14 years of close or either absolute control in ... Congress and the Executive Branch ... And there has been ... two very opposite polar ends. If you had someone that could come in and just make deals and not worry about the next cycle, getting elected, we'd probably have some compromise.

I always think of it from a business [perspective] — if both parties are unhappy it was probably a good deal. If one is happy and the other one is not, then someone didn't get a great deal and vice versa. That's what I think we're missing right now.

Everyone knows the issues this country needs to deal with. The debt one is huge, and it looks like that's what's kind of slowing things down because we've got to deal with it. But there are other things that would release the business community to go out there and really make some long-term investments. But you've got to have a CEO that makes the deal, and shakes hands, and says, "We're going to do this because it's for the greater good of the company" or, in this case, the country [and] is not worried about the board, or not being there when it comes time to campaign.

Wilson: Ryan, you said it very well. We need someone who can cause that kind of change ... I don't know what it's going to be. But those partisan [differences] come up so severely in every single issue. It's almost disgusting. And when you hear other people, other commentators or journalists in other countries talking about our country and how we can't get along, how things can't get passed, and who is going to stonewall the other person, there just has to be ... I can't think of another word other than a change in the culture of our Congress no matter who is in that seat. **VB**



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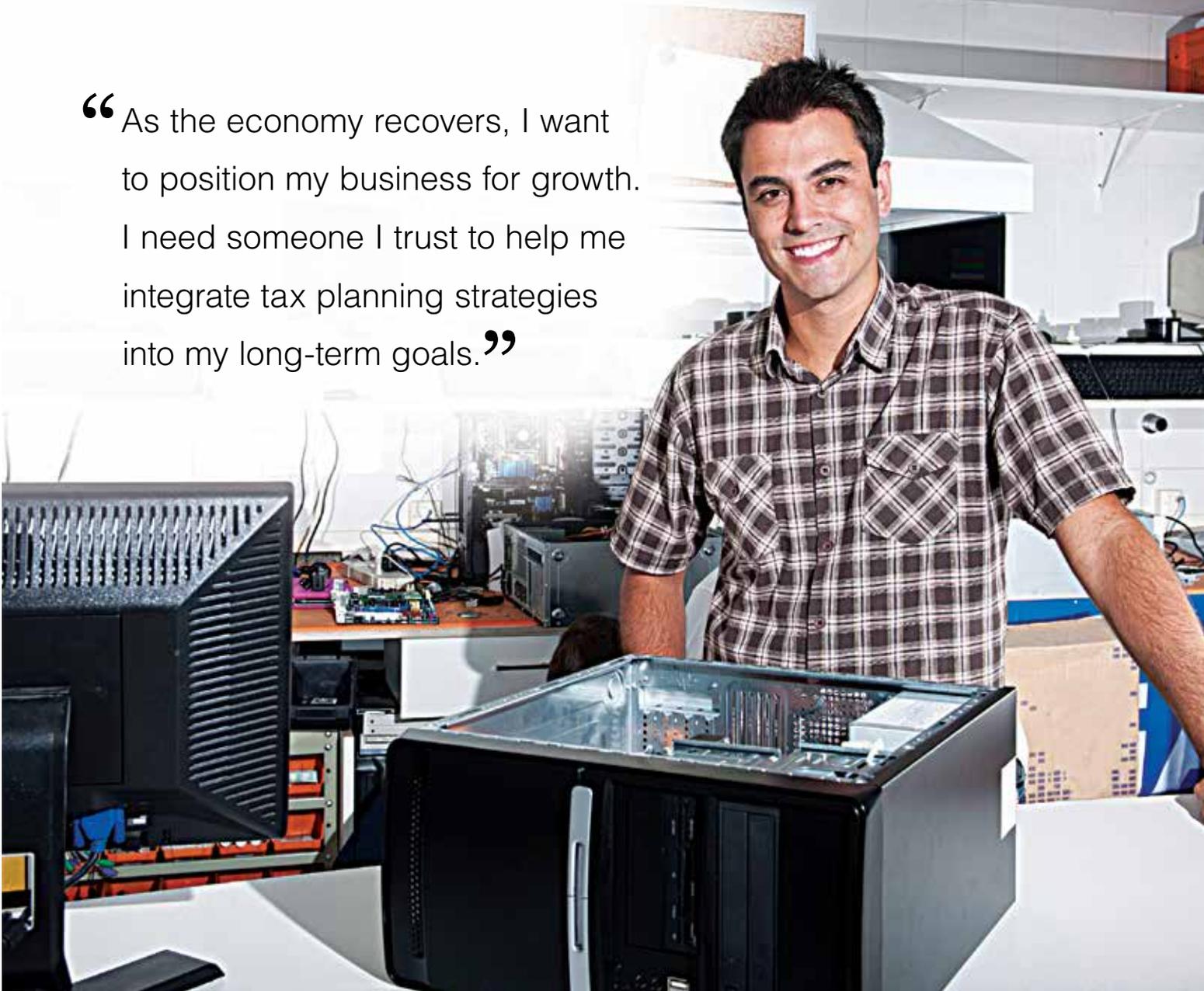
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